

RD AN No. 3864 (4279-A and 4287-B)
May 16, 2003

SUBJECT: Business and Industry Guaranteed/Direct Loan Programs
Transaction Screen Questionnaire and
Phase I Environmental Site Assessments

TO: State Directors, Rural Development

ATTN: Business Programs Directors, Rural Development Managers,
Community Development Managers, and
State Environmental Coordinators

PURPOSE/INTENDED OUTCOME:

The purpose of this Administrative Notice (AN) is to provide guidance on how to evaluate the economic impacts posed by contamination from release of hazardous substances or petroleum products when determining the liquidation value of real property in the Business and Industry Loan Programs. This AN applies to RD Instructions 4279-A and 4287-B.

COMPARISON WITH PREVIOUS AN:

This is a reissue of Rural Development AN 3733, "Transaction Screen Questionnaire and Phase I Environmental Site Assessments for Business and Industry Loan Programs," which expired April 30, 2003.

EXPIRATION DATE:
May 31, 2004

FILING INSTRUCTIONS
Preceding RD Instructions 4279-A and 4287-B

IMPLEMENTATION RESPONSIBILITIES:

In liquidation cases, it is the responsibility of the lender to obtain the maximum amount from liquidation. In the liquidation plan submitted to the Rural Business-Cooperative Service (RBS), the lender provides an estimate of the current market and potential liquidation value of the collateral if the current loan balance, including accrued interest, is less than or equal to \$200,000. An appraisal report by a qualified independent appraiser is required on all collateral securing loans where the current loan balance is more than \$200,000, including accrued interest. The purpose of an appraisal report is to permit the lender and RBS to determine the appropriate liquidation actions. Paragraph VI, A.4., of the Lender's Agreement, Form 4279-4, allows RBS to share the cost of the appraisal report equally with the lender.

In order to formulate a liquidation plan which maximizes recovery, the collateral must be evaluated for the presence of contamination from release of hazardous substances or petroleum products which may adversely impact the market value of the collateral. An appraisal which does not consider this aspect is incomplete and possibly misleading. Because these environmental evaluations are performed in conjunction with the appraisal process, the cost of these evaluations may also be shared equally between RBS and the lender.

An evaluation of the environmental condition of collateral is made by conducting due diligence in conjunction with the appraisal. With regard to this AN, due diligence is defined as the process of evaluating real estate, in the context of a real estate transaction for the presence of contamination from release of hazardous substances or petroleum products, and determining the effect, if any, the contamination has on the regulatory status or security value of the property. If contamination is present, the cost of environmental restoration activities can be estimated and used to adjust the market value of the collateral. The process of due diligence is designed to reduce but not eliminate uncertainty regarding the environmental condition of collateral and meet the "appropriate inquiry" and "due care" provision in the Comprehensive Environmental Response Compensation and Liability Act, 42 U.S.C. 9601, *et seq.*

For loan servicing actions, due diligence consists of a two-step process which includes the (1) Transaction Screen Questionnaire (TSQ) and (2) Phase I Environmental Site Assessments (ESA) which are published by the American Society of Testing and Materials (ASTM). RBS considers these two documents to be adequate format for performing due diligence. Lenders may contact the State Environmental Coordinator for assistance in incorporating due diligence into their liquidation plans. It is not necessary to

complete both steps in performing due diligence; it is necessary only to complete the level of review required to ascertain and document economic risks posed by contamination.

The ASTM two-step due diligence process is further explained as follows:

The TSQ is defined as the initial level of inquiry which evaluates the environmental condition of collateral and concludes whether or not additional evaluation is necessary. The TSQ is designed as a series of questions that determine present or past land uses or activities which may have or appear to offer the potential for adversely impacting the environmental conditions and market value of collateral. If the results of the TSQ are inconclusive and professional review and judgment are needed, then the next level of review, a Phase I ESA, may be necessary to clarify the issues raised by the TSQ.

A Phase I ESA is a detailed investigation and evaluation of a property's environmental condition and involves a review of all pertinent records, a site reconnaissance of the property, interviews with current and past owners or operators of the property, and the preparation of a brief narrative report communicating the findings and conclusions about the environmental condition of the property. The Phase I ESA may indicate a need for further detailed investigation, in the form of a Phase II or Phase III ESA, to determine the extent of contamination, remediation measures and associated costs. The Agency and the lender, if further investigation is warranted, may share the cost of these additional investigations.

An environmental professional may be needed to perform Phase I ESAs. For the purpose of this AN, an environmental professional is defined as a person trained in the fields of environmental science and engineering or one who has the experience necessary to perform a records review, the ability to adequately evaluate the environmental conditions of a site by conducting a site reconnaissance, and the ability to perform other activities, in accordance with the ASTM standards. From this information, an environmental professional will develop conclusions regarding the environmental status of a site and, if necessary, develop remedial options and estimate the associated costs. This information is then shared with the appraiser so that a more accurate determination of market value can be made. Remediation plans proposed in ESAs are to be cleared with State or local agencies having jurisdiction over site remediation activities.

Lenders should be encouraged to utilize these ASTM standards, as RBS considers them to be an effective way to determine and document the environmental condition of collateral and reduce the potential effect that an adverse environmental condition will pose to the market value of the property, particularly at the time of liquidation.

If you have any questions on this issue, please contact Nichelle Daniels, Loan Specialist, Business and Industry Division Servicing Branch, (202) 690-1754; or Linda Rodgers, Technical Support Branch Chief, Program Support Staff, Rural Housing Service, (202) 720-9647.

(Signed by John Rosso)

JOHN ROSSO
Administrator
Rural Business-Cooperative Service